

# Economic Policy Review

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## In the issue

**2004: Ten Important Positive Developments in Bulgaria**

**The Unnecessary “Nuclear Toy”**

**About the Government Employment Programs**

**Potential for Real Estate Development in Bulgaria**

**Key Obstacles to Private Business in Bulgaria: IME 2005 Report**

## **2004: Ten Important Positive Developments in Bulgaria**

**Georgi Angelov**

In 2004 we witnessed not only negative things in Bulgaria, but some positive developments, as well. They are important because they lead to increased prosperity of Bulgarian citizens.

### ***1. Privatization***

Privatization is important in order to achieve faster economic development – the bigger the private sector, the more value added is created because of the strong economic incentives that affect the private sector, but not the state.

In 2004, according to the Privatization Agency, shares of 1376 companies were sold. Of these 1168 were minority packages (remaining state shares in already privatized companies) and 208 were sales of majority packages of shares. The total financial effect of these transactions is about 3 billion leva<sup>1</sup>. In 2004 are privatized 2.58% of the state assets so till the moment the privatized assets are more than 57% of all state assets. In 2004 are privatized more assets than in 2002 and 2003 put together. Furthermore, several strategic privatizations were made – the Bulgarian Telecommunication Company was sold as well as the electricity distribution companies.

### ***2. Lower taxes for the entrepreneurs***

Taxation affects the incentives for creation of more wealth and jobs. Lower taxes lead to more entrepreneurship and more investments. Therefore lower taxes are important for increasing the rate of economic growth.

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<sup>1</sup> Under the currency board arrangement the exchange rate of the lev is fixed at 1.96 leva per Euro.

The corporate tax was cut to 15% and after that Bulgaria is among the 8 countries in Europe with lowest corporate tax rates and is equal with four of them. Moreover, the dividend tax was cut by half to 7% (0% for EU residents). Furthermore, the tax-deductible depreciation rates for new production equipment were increased. What is more, the top marginal tax rate for individual income was cut to 24%.

### ***3. Third GSM operator***

Competition and new companies that enter the market lead to increased benefits for the customers through lower prices, more diversity and higher quality of the goods and services. The branch is developing faster and the connected branches are also benefiting. As long as the communications are important for most businesses the increased competition will have positive effects on the economy as a whole.

Along with the privatization of the Bulgarian Telecommunication Company the third GSM license was given to the company. It is expected the third GSM operator to start delivering its services in April. After that we expect positive effects for the consumers.

### ***4. The minister of finance defended the classical liberal ideas***

The ideas for a society, based on liberty, private property and individual initiative made the United States of America and the Western World the wealthiest and most prosperous part of the world. These ideas, that we call classical liberalism (or libertarianism) were not so well known in Bulgaria. However, that is changing. With the passing of time more and more people realize the importance and advantages of the market economy, private property, competition; realize liberty as a high value. That development has serious positive effects on the economy. It

was the basis for the December libertarian speech of the minister of finance Milen Velchev (and probably was reinforced by it) in which he defended the classical liberal principles, insisted on zero profit tax and flat income tax.

#### ***5. Increase of investments***

In order to increase the wealth more must be produced. In order to produce more, there is a need for more productive assets, i.e. capital. Therefore the increase of investments is important for increasing the possibilities of the economy to produce more. Three consecutive quarters the gross fixed capital investments are above 20% of GDP and the foreign investments are also increasing.

#### ***6. Socialist party is becoming aware of the economic rationality***

For the economic development to persist, all parties with chances to win the elections must realize the principles of economics. This reduces the risks and the long term (private) planning becomes possible. In 2004 some signs are noticed that socialist party starts to realize the importance of the business for development. Bulgarian Socialist Party supported the corporate tax cut to 15% and even proposed zero corporate tax on the reinvested profit. Moreover, it hinted that government spending must be capped at about 40% of GDP. Without exaggerating these signs of development in the socialist party, we cannot let them pass and we encourage them.

#### ***7. Fast growth of the private sector***

During the first three quarters of 2004 the private sector increased by 10%. As the private sector accounts for 77% of the economy, this development has positive effects on the economy as a whole, despite the drop of the public sector. The fast increase of the private

sector will result in more employment and higher wages. This will increase the trust in the private sector, which is beneficial for the long-term development.

#### ***8. Integration in the global economy***

The more an economy is integrated in the global economy, the more opportunities for creation of wealth prosperity exist. This is especially true for small open economies like Bulgaria. The international trade of Bulgaria (the sum of the import and export) reached 127% of GDP, which is a good indicator for the present situation.

#### ***9. Low inflation***

The low inflation creates opportunities for more efficient usage of money as unit of account and medium of exchange; it decreases the inflation tax rate and creates economic stability. In the years as a result of the introduction of the Currency Board Arrangement the yearly inflation in Bulgaria is low and the exchange rate with the euro is constant.

#### ***10. The flat tax gains momentum***

The proposal of the Institute for Market Economics for introduction of a flat rate of 10% for the income tax, corporate tax and social security tax gathers momentum. It was publicly endorsed by more than 100 economists, financiers and intellectuals in an open letter. To a great extent some of ideas were supported by politicians of different political parties. The minister of finance supported the economic and social importance of a flat tax. UDF proposed 10% corporate tax rate and 10-20% social security tax rate. DSB defended the need for a lower tax burden. The chances for Bulgaria to turn into a low tax country are increasing.

### **The Unnecessary “Nuclear Toy”**

Martin Dimitrov

Last developments indicate that the government has firmly decided to launch a second nuclear plant project – “Belene”. However all questions concerning economic feasibility remain unanswered as the only backing used insofar are based either on populist grounds (Bulgaria to become center of energy on the Balkans) or on

unproved expectations for electricity shortages around 2010-2011. IME team insisted for more than two years that a full regulation impact assessment is absolutely relevant although the government did not presented such analysis to the larger public.

Mr. Georgi Kaschiev (former president of the Committee to Use Nuclear Power for Peaceful Purposes) supported our argumentation in his report arguing that the net present value of this

project seems to be negative and that this project may significantly hamper planned energy market liberalization. He states that the very need of additional power has not been proved yet backing his argumentation with international comparisons and calculations.

Herein we present to your attention a brief list of main argumentation against the second nuclear plant project:

1/ The need for additional plant has not been proved. Energy consumption in Bulgaria (consumed energy per one unit of GDP) is several times higher compared to EU average or Eastern Europe countries' average. Therefore potential savings are a serious alternative to building new power facilities.

2/ It has not been proven if there is a need of any additional electricity production at all that it should be nuclear. Rehabilitation of existing thermal and building additional hydro plants appear to represent a serious alternative to nuclear projects. Up to now there is no cost and benefit analysis of different alternatives.

3/ Electricity transportation losses in Bulgaria are from two to three times higher compared to Germany or Italy. Thus it is not clear why efforts are not focused on transportation saving technologies instead of building additional powers.

4/ There is no cost and benefit analysis of the "Belene" project and there is no indication that the government is even considering such. For instance the costs for the secondary infrastructure may turn to be considerable higher than all existing expectations. The same issue exists with waste disposal.

5/ Market liberalization will both change structures of supply and demand, which additionally complicates all forecasts.

6/ Electricity imports may turn to be more cost efficient than local production. With this respect the biggest problem appears to be stereotypes from the past as imports are considered lost per se. This way of thinking is wrong especially if we realize that Bulgaria is importing around 80%-85% of all energy resources.

7/ Bulgaria's participation at the European energy system allows to maintain lower reserves, which should be also taken into account when forecasting the energy balance.

8/ Price per kwh will most probably turn to be much higher than existing expectations. If comparing with similar plants in other countries it would be more reasonable to expect prices around 5-6 eurocents per kwh.

9/ Market solution of "Belene" case would be if the existing infrastructure is sold at an open tender and is used according to decision of new owner. If there is private interest to build additional nuclear facilities without any government support than all related risks are taken by investors.

10/ The proclaimed idea to merge "Kozlodui" power plant to "Belene" plant is an example of non transparent privatization. It would complicate or would rather make impossible all economic calculations and would hide the actual results from "Belene" project. If this idea takes place we would probably never know the real price of kwh since all data will be mixed.

### **About the Government Employment Programs**

Dimitar Chobanov

During the first few days of the year something that induced discontent among the people and particularly among the municipalities' managers happened. These are social ministry's employment encouragement programs funds for which were reduced or redirected to the district administrations. At the end, something that IME forecasted at the initiation of these measures

happens and when the program is over the temporary employees will be unemployed again.

What is the purpose of employment encouragement measures? These measures were taken when the rate of unemployment was very high due to restructuring of the economy. During the privatization process, many inefficient jobs were cut thus leading to higher unemployment. However, during the last few years the economy accommodated to the new conditions, part of the workers changed their occupations and shifted to other industries. As a whole, there is a tendency toward higher share

of the value added from the services sector at the expense of industrial sector and this implies different requirements to the companies' personnel in terms of skills and qualification.

Given these circumstances, it is natural that some persons cannot adjust so easily and lose their jobs. However, as the economy has evolved and there has been a stable (although not so high as we wish to be) growth, persons have gradually started to find jobs and the rate of unemployment has fallen. At this moment, the government interferes with its employment encouragement programs which actually create subsidized unproductive jobs. Its purpose is to disguise social aids as compensation for a work with doubtful benefit. Most of the persons employed in these programs were not motivated to do their particular job and the results were unsatisfactory.

The costs on these programs were BGN 217 mill. (EUR 111 mill.) in 2003, BGN 141 mill. (EUR 72 mill.) in 2004, and in 2005 they are expected to reach BGN 127 mill. (EUR 65 mill.), so the total is around BGN 485 mill. (EUR 248 mill.) for the three years. For this money, however, not a single job is created actually because when the programs stop the temporary employment will disappear. This is to happen in 2006 because the programs are projected to continue for three years.

Moreover, the real long-run effects of these programs are negative to the persons involved. In the short run it seems to them they have a benefit as they take some money. However, during this period, they work at low productive or, even, unproductive jobs. The program continuation generates expectations that it would not be terminated at all and, thus, discourages people to search for another job that could be permanent for them.

According to businessmen, such programs have a negative influence over the seasonal employment. Workers are discouraged to accept seasonal job that could add more value because it prevents them participating in the subsidized programs due to the legal requirements. Another reason for seasonal employment denial is that larger efforts are needed there because if a particular activity is not aided by the government the employer cannot afford to pay

as many as in a subsidized program. The effect is that inefficient government or quasi-government sector employment has crowded out the efficient private sector employment and has impeded creation of new productive jobs.

Major loser from the funds reduction for the program are the municipalities and therefore they oppose to this heavily. As a beneficiaries of this money they could use it to finance some local activities. Logically, when some persons in the municipality are dependent on it as an employer they can easily be attracted to vote for the active majors and municipal counselors. However, during this pre-election period, the ruling coalition having not sufficient number of majors is trying to expand its influence through transfer of program activities to the district administration that are directly subordinated to the central government. In such case, the government is seen as an employer and a reorientation of votes is expected if program is continued. There is an option, of course, that it would not happen and the effect could even be opposite to the desired of the ruling coalition and a proof of it is the public outcry in some regions.

Another consequence could be drawn if an analysis of the opportunity cost is made. In 2005, these BGN 127 mill. could be saved to the taxpayers in the form of corporate income tax reduction to the rate of 10 per cent. It would create a strong incentive for investment in Bulgaria from local and foreign sources and capital inflows. The 10 percent corporate income tax would make Bulgaria one of the most attractive places for investment and would imply creation of real productive jobs outnumbering these from the program. Thus, the purpose of job creation would be fulfilled in the best way. This employment would not be temporary and would not be paid by all taxpayers, and would add value to the economy instead of redistribution of funds from working and enterprising persons to non-working ones thus restricting the economic growth.

As a conclusion from this reasoning can be said that the cutting of funds on this social program would have positive effects for the whole economy and has to be done as quickly as possible.

## Potential for Real Estate Development in Bulgaria

Svetla Kostadinova

Real estate market in Bulgaria witnessed strong development in 2004. The apartment prices registered almost 50% increase<sup>2</sup>. However, the real increase is much greater and is not registered by official statistics because of the incentives of market participants not to report the real transaction price. Among these, the most important are avoiding paying notary fees from buyers and sellers and avoiding of paying higher corporate taxes from real estate developers and construction companies.

It is important to notice that not all parts of the country registered significant increase but rather several big cities (biggest seacoast towns, the capital, 3 – 4 large places with dynamic growth and higher employment, as well as several mountain resorts). The most important reasons for this increase are:

- Stable economic growth for the past 3 years – 4.5% on average GDP growth
- Increase in incomes (slight increase for certain groups of people).
- Changes in bank's policies toward housing finance – interest rates are falling, loans conditions are improving and the strong competition is changing overall banks' behavior.
- Increasing of savings – they are the basic source for investment in the economy.
- EU forthcoming accession and expectations of equalizing Bulgarian prices with EU levels.
- Foreign citizens' buyers of newly built luxury summer apartments and cottages in the mountains).
- Huge increase of foreign direct investments in 2004 increased the demand for special real estates.
- Legislative environment – introducing of Law on Special Purpose Investment Vehicles (2003), Law on Mortgage

Bonds (2000) facilitated real property development and allowed for bigger scale investments.

- Bulgarian emigrants' remittances – remittances are registering strong dynamics - in 2001 they represent 49% of FDI<sup>3</sup>. Many “returning” emigrants are investing their money in real estates or are sending funds to relatives for the same purpose.
- Psychological - people's perceptions that property is among the most secure investments and will remain profitable is predominant. Lack of many alternatives for similar risk investments is holding up interest in real estates.
- National moods – Bulgaria is among the countries with highest ownership rate. According to official statistics approximately 91% of people do own their place of residence.

### Brief review of basic real estate markets

The *office market* is always more sensitive to changes in economy and therefore we expect the demand for vacant plots to continue. If the current trend of economic activity in the country continues, several factors (growth of employment, increasing demand of goods and services, expansion of current businesses) will determine growth of demand for real estate. Besides foreign investors who are among the main users of newly built office spaces, Bulgarian business is starting to look for representative places and for acquiring land for their activities.

*Apartment* prices continue their growth since 2002 mainly because of expansion of housing and mortgage credit by banks, as well as steady demand. The combination of central bank measures to restrict credit expansion and reducing (absorption) of number solvent buyers make the competition for quality clients harder than before. An interesting phenomenon is the fact that small apartments are holding their prices steady and even registering increase in prices. This can be attributed to dominance of smaller households (up to 2 members) because

<sup>2</sup> According to National Statistics Institute.

<sup>3</sup> Constellations, Incentives and Provisional Impacts of Migration Related Policies, IME, 2005, [link](#)



of lower birth rates and emigration in recent years.

**Industrial plots** are one of the hits on the market. Foreign investors' interest, as well as demand from big Bulgarian companies who want to expand their business is increasing and we expect future positive trend. Geographical location and convenience for logistical spaces presupposes higher return from building such estates.

**Retail spaces**, in particular malls are witnessing strong development in the last 12 months. There are several big project undergoing that are to be finished in next two years. The multiple advantages of such trade centers such as concentration of many and different services rendered in one place, as well as parking space available are among the main reasons for their attractiveness for both future renters and investors. Investment in such activity is proved to be profitable in next 5 years at least.

**Hotels'** development is registering strong growth in last 4 years. Old hotels are refurbished, newly are built – several banks committed to financing at preferential conditions certain developers in mountain and sea resorts. Some of the biggest international tour operators already invested in Bulgarian hotels improvements and brand new ones. The local and foreign interest in Bulgarian tourist sector is about to be growing in the future and the investment in such types of real estates to be profitable. Infrastructure, labor force qualifications and skills, as well as business regulations are being seen as obstacles but fortunately we see improvements and the near forecast is positive if current trend of reforms remains.

#### Current legislative developments

At the moment there are several draft laws or proposed changes in current laws that are of special interest for real estate market development.

1. Changes in Constitution – Bulgarian parliament has to adopt changes in the main law so that to define if transition period for acquiring land by foreigners will be applied. This should be done by end April 2005 since then Bulgaria is expected to sign the EU accession treaty. Broad debates over exact conditions for acquiring land by foreigners are ongoing in Bulgaria in years. The main notions are: we should apply transitional period until 2014 (Bulgaria has negotiated 7 years transition period after accession in 2007) like most new EU members so to protect the country from “buying out” our land. The other opinion is that there should be no transition period at all and land should be free for everybody no matter nationality. Liberalizing land market in this case will give opportunities for both investors and businessmen and owners. Of course, the positive effects of full liberalization of land market is the best way and if we want to be competitive with EU-25 we should decide on this as soon as possible.
2. Draft law on introducing of bauparkasse system in Bulgaria – it introduces 5 year compulsory saving period and fixed interest rate difference on savings and loans obtained by the bauparkasse. A fixed sum will be provided by the state budget but no more than certain amount that should be approved each year. The discussion so far showed resistance from experts and the draft law is not “in the pipe”. The new Parliament however (if socialist party wins majority) can reopen the discussions on the law and thus impose additional burden on the budget without having the possibility to effectively control the system.

## Key Obstacles to Private Business in Bulgaria: IME 2005 Report

Krassen Stanchev

### Contents:

Background.....	7
1. Obstacles related to property rights, freedom of contract and equality before the law	7
Property rights .....	8
Freedom of contract.....	8
Equality before the law .....	9
Solutions and progress.....	10
2. Taxes and conventional tax burden: systemic issues.....	10
Who pays taxes? .....	10
Procedures: how are taxes being paid?.....	11
Corporate tax .....	11
VAT .....	12
Income tax reporting (SMEs) .....	12
Solutions and progress.....	12
3. Credit-related institutional obstacles .....	13
Contracts between private parties.....	13
Overall shape of bank and non-banking sector policies .....	14
Solutions and progress.....	14
4. Obstacles related to the competitiveness of the workforce.....	16
Costs and the limits of informality .....	16
Practicalities .....	16
Solutions and progress.....	16
5. Obstacles related to public procurement.....	17
Business worries.....	17
Solutions and progress.....	17
6. Obstacles and challenges related to EU accession .....	17
Major obstacle .....	17
Challenges .....	17
Attachment 1: Respondents.....	19
Attachment 2. Productivity Dynamics.....	20

### *Background*

Representatives of the business community<sup>4</sup> were asked to identify six major obstacles to private sector development and name policies to overcome them in a short- to mid-term period. The experience showed that there was a need for instruction, namely: a) to avoid monetary policy area; b) to concentrate on issues that are policy driven, e.g. do not stem from market constellations, and therefore are subject to impact by different policy mixes.

Not all respondents went up to six obstacles. Besides, there were themes that reappeared throughout the discussion of obstacles. These themes were: EU accession, taxes and social welfare contributions and corruption. Neither the respondents nor the author believed that corruption is an independent variable. We attempt not to discuss the themes separately but from different angles along with the obstacles.

### *1. Obstacles related to property rights, freedom of contract and equality before the law*

FIAS Survey of 2004 revealed that 60% of the firms find the government inefficient and that the senior managers spend 25% of their time dealing with regulations – two times worst than the second problematic

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<sup>4</sup> For better orientation we present brief information on respondents in Attachment 1. The opinions expressed in this paper are strictly those of the author.

## **Institute for Market Economics, Bulgaria**

country, Serbia. It is a perception, which indicates that private sector is dependent on and subject to undue intervention.

Our respondents rated enforcement of private property rights as “most important but very difficult to deal with” since they are multiplied by different regulations for different walks of life.

### **Property rights**

In 1989-1998, the key regularity of institutional reforms has been: no regulation when using other people’s (including taxpayers’) money, but over-regulation when people use their own properties and savings.

At its roots, this is a constitutional deficiency. Article 7 of the Constitution proclaims that “the state shall be held liable for any damages” but in fact says that these should be damages “caused by illegitimate [in Bulgarian – “illegal”]<sup>5</sup> rulings or acts on the part of its agencies and officials”. In other words, if acts were based on a law it would be difficult to reclaim damages. This explains to some extent the legal fetishism of the Bulgaria business framework, the zeal to regulate and the legalistic opposition to reducing administrative barriers, multiple amendments to the privatization law (29 for the period 1992-2000 and three different concepts of privatization process since 2001). Different sets of government have changed regulations as they found fit to their interpretation of “public interest”.

Series of decisions of the Constitutional Court (6/1997, 10/1999, 2/2000, 3/2000) underline that the proclaimed “free economic initiative” (Article 19.1) is limited if restrictions “are promulgated with the objective to protect public interest and are legally advisable”. At the same time there no procedure to assess how advisable is the law and what and how “public interests” are protected.

Preliminary controls hamper the entire life of the firm: its registration, commencement of activities, operations and liquidation. The government is a privilege creditor and governments appointed experts appraise the collateral in bankruptcy procedures.

### **Freedom of contract**

There are traditional areas in which government intervenes in the freedom of contract.

1. Most important and difficult reforms is the area of labor regulations. Business associations have been more successful in reforming taxes than labor market regulations.<sup>6</sup> Since Spring 2001 (public hearing on last major amendments of the Labor Code) legal and policy conditions that create wrong incentives deteriorate. Longer-term constellations are discussed below. Comparisons with neighboring countries are disappointing, even in relation to Serbia – a late reformer with a background of trade union ownership of enterprises.<sup>7</sup>

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<sup>5</sup> Often the authorized English version of the Constitution (as it is available on the website of the National Assembly and the Constitutional Court) does not fully correspond to the original text.

<sup>6</sup> Some organizations, most notably Employer Association of Bulgaria (established in 2000), were focused on labor regulations (see: <http://www.eabg.org/n101100.html> ), which is a second topic most often highlighted in talks with the government.

<sup>7</sup> IME, Study of Incentives, Characteristics and Strategies of Firms Operating ‘in the Shadows’ (180 Firms Survey in Bulgaria, Romania and Serbia), Sofia, IME, p. 34, available at: [http://www.ime.bg/pdf\\_docs/papers/\\_Toc71455348](http://www.ime.bg/pdf_docs/papers/_Toc71455348)





Scale:

- It is not a problem at all = 1
- Insignificant problem = 2
- Do not have influence = 3
- Serious problem = 4
- Very serious problem = 5

Latest surveys (including that of FIAS) fail to identify problems because questions are not asked and because, when asked, the answers add the burden to costs of dealing with the government. Most of our respondents were on the opinion that legitimate, bigger and more competitive businesses suffer in the first place.

2. Another area is the area is banking and finance. The early 1990s lack of regulation has been converted to over-regulation. It is visible in pensions, special purpose investment vehicles (probably the most restrictive regulation in Europe), in discretionary licensing of insurance industry, etc.

Bankers and bank lawyers are divided on the issue whether a court in Bulgaria would definitely have an appropriate understanding that the rule to be applied must be the depositor and the institution. In the tradition that for a long time benefited debtors, it is possible, some say, that depositor sues a bank to refund without agreed penalties, i.e. that the court would decide that the applicable is rule is the law but not the agreement.

### Equality before the law

1. Reading the law by tax authorities is different from institution to institution and from individual to individual. In some sectors, where marketing abroad uses consignment, the goods reach the buyer after a period of time; respectively the payment is executed after completion of the deals. On such situations there is an instruction on how to apply VAT procedures. But the practice is different. As one of the interviewed told us, in their case they followed thoroughly the instructions because for logistic reasons exports to EU (by road, lorries) uses 21 days payment period while the export to North America (by ship) – 35 days. Nonetheless, in contradiction to Chief Tax Directorate official prescriptions, Directorate representatives repeatedly required that the firm transaction and VAT reports (actual receipts and invoices) are submitted at the day the goods leave the country not after the goods “change hands” and the actual transaction is executed. In the experience of the firm in question so far, tax inspectors have been always acknowledging the correctness of the firms reporting.

2. Opposite to high value added exports, firms operating of the domestic market for food (in the case of our respondent – milk products) face a different challenge. First, suppliers of milk are small and not VAT registered. Second, many of them hide the values and under-report. Big payers are unequal; they are between 200 dairies (all VAT registered) and 200,000 suppliers. 40 dairies produce 80% of the milk; roughly only 20% of the market is fully accounted for. The firms that can possibly be subject to controls

by tax and other authorities are 20, maximum 40.<sup>8</sup> As one of the respondents from another industry described the situation: “you are big and transparent, you will be beaten”.

3. Similar is the situation in the furniture industry: the “backyard carpenters” use stolen timber and save almost hundred percent of taxes on labor (personal income tax, social security contributions). Since they have limited number of recorded (invoiced) sales, they are not VAT registered, and therefore charge no VAT to the consumer, thus gaining a 20% price advantage to registered companies. These competitors operate mostly in low-tech product markets, i.e. producing goods with more labor and less machinery. Such are for example basic kitchen chairs, plain tables, simple cupboards, shelves, beds, etc. The outcome is that bigger companies are slowly exiting this segment of the market by either changing the product structure entirely, or improving quality and product.

4. The lack of implementation of technical and accounting standards and other legal requirements is a typical phenomenon. The market for medical supplies is believed to be only 25% complying with the requirements. Even earmarked programs to assist people with disabilities are executed in a manner that prevents the implementation of standards<sup>9</sup>. Wine and liquors trading has been heavily regulated and subject to “licensing” but it is the merchant who is liable if caught with improper excise labeled stock. Veterinary service is usually after big companies. Meat product market is in a similar shape as that of milk.

### ***Solutions and progress***

The labor market rigidities have been discussed for years and private sector fails to advocate and promote reform. Liberalizing labor contracts could be conditionality to international assistance programs and loans (IMF and/or World Bank but not EU). It is unlikely that Bulgaria government or political establishment would dare to initiate reform on their own, without international backing. (Other contract enforcement issues fall into the domain of obstacle discussed below.)

The irony is that legal fetishism is to be dealt with by legal means but it is not possible to rely on concerted efforts to amend rules in these sectors. The three sub-categories of obstacles should be introduced via a regulatory change. It is relatively easy in the case of labor markets. In other areas there are no quick-fix solutions.

Other EU accession countries have established procedures that help public dialogue and participation when regulation of “public interest” is at stake. The progress to date is the adoption but not the implementation of the law on regulatory regimes.

### ***2. Taxes and conventional tax burden: systemic issues***

This issue is a reoccurring theme in the interviews and we will attempt highlighting its systemic nature.

Since 2001 roughly 50% of publications and communications to the government by major business associations like BCCI, BIA and BIBA were dedicated to taxes, social welfare contributions and related procedures.<sup>10</sup>

### **Who pays taxes?**

Meanwhile, the demographics of taxation is such that few finance the many.

1. Bulgarian citizens who produce income are 2.2 million (employed in public and private enterprises) or 33% of those above 15 years of age. The rest 67% are net beneficiaries of redistribution and include pensioners, state and local administration and all employees paid by the budget (excluding non-subsidized SOEs), unemployed and those who receive government stipend.

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<sup>8</sup> We check this statement by visiting sanitary inspections and labor safety inspection websites; all bigger milk producers or their branches are quoted there.

<sup>9</sup> See for details: People with Disabilities, CIL/IME 2003 Annual Report, at: [http://www.ime.bg/pdf\\_docs/papers/report\\_2003\\_eng.pdf](http://www.ime.bg/pdf_docs/papers/report_2003_eng.pdf).

<sup>10</sup> See the respective sites of BCCI - <http://www.bcci.bg/bulgarian/law/apendix.htm> (in Bulgarian); of BIBA - <http://www.biba.bg/Publications.asp> (in Bulgarian and English), and of BIA - <http://bia-bg.com> (in Bulgarian). The growing public attention to taxes is linked to consolidation of revenues and tax reforms in the late 1990s. The incumbent government increased expenditures while claiming that it is going to introduce different tax incentive.

***Population above 15 years of age***

	Million.	% of those above 15
Employed by the private sector	1.9	28
Employed in government owned industries	0.3	5
Employed in government financed activities	0.6	9
Unemployed, students, other	1.5	22
Pensioners	2.4	36
Total	6.7	100

Source: IME on NSI 2002 data on the population and 2003 on employment.

2. On individual level the situation is also strained.

A Bulgarian, 30-40, working on a contract or as sole proprietor and receives a gross monthly income of BGN 1,000, would encounter the following situation. He/she should pay 29% (compulsory) pension insurance and 6% (mandatory) health insurance on BGN 850; in other terms he/she contributes to quasi-government funds BGN 297.5. The income tax on the remaining BGN 702.5 is BGN 149. The remaining BGN 553.5 is for consumption. According to the MOF and NSI assumptions he/she will spend 80% of this amount on VAT-taxed products and services, i.e. another BGN 74 would go to the treasury. If he/she drives a car and consumes 50 liters a month, excise duties would be BGN 22 and if he/she smokes and drinks as the “average” Bulgarian, duties are BGN 12. What remains is BGN 445. The calculation is not complete but choices must obviously be difficult since there are other options to invest, consume, redistribute within the family, etc.

Assuming that forecasted average wage for the year end is BGN 307, an ideal worker would pay (compulsory) BGN 32.77 insurance contributions; the employer – BGN 98.32. On the remaining BGN 274.23 the employee owes income tax of BGN 34.30; his/her net wage is BGN239.93. Employer’s costs are: BGN 405.32.BGN 165.39 would go to the government, being squeezed between employee’s actual work and what he/she gets from the employer. The amount squeezed is BGN 40.8%, i.e. the worker gets less than 60% of what he/she contributes to the economy. Presumably, either side of the contract has significant incentives to select non-compliance tactics.<sup>11</sup> 3. FIAS 2004 survey of obstacles indicated just negligible improvement from 2002, besides the reduction of corporate tax rate, reduction of the lower threshold for income tax and shortening of VAT refund deadlines by the time of the survey.

**Nominal tax rate reforms**

	2001	2002	2003	2004
Corporate tax	28%	23.5%	23.5%	19.5%
Income tax	20-38%	18-29%	15-29%	12-29%
Welfare contrition	42.7%	42.7%	42.7%	42.7%
VAT	20%	20%	20%	20%

Source: *State Gazette*, 2001 – 2004

The explanation is, perhaps, in the fact that taxes are perceived as a combined burden, including corporate and income tax, and the employer/employee social welfare contributions. (FIAS 2004 did not ask about the latter.) The conventional wisdom is that it is very likely that social transfers to the budget hamper development of SME and individual entrepreneurs. Our respondents made a point that it is not exactly true, and that it is often the case with “big tax payers” (corporations) suffer as well. The mechanism they reveal is that they loose trained work force to competitions

**Procedures: how are taxes being paid?**

**Corporate tax**

In 2005 the corporate income tax will be reduced to 15% and will be flat. The difference between corporate and personal income rates for high-end income group (successful managers, entrepreneurs,

<sup>11</sup> Obviously, this is not a certain behavior but only only an indication that there is a systemic issue.

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competitive workers, etc.) is significant. There are incentives to “corporatize” personal expenditure of those who control corporations.

### **VAT**

1. Almost 90% of VAT revenue accrues at the time of import; it is common phenomenon that VAT is paid at import but Bulgaria is a rather extreme case. Accrued revenues from domestic sources have been negative in some months because of refund claims (both domestic and export). VAT revenues are currently about five percent (5.6%) of GDP and there are about 87,000 VAT taxpayers (about 1/3 of the so-called active firms)

2. As Bob Conrad of the Duke Center for International Development (Duke University) has found out: “It appears that the tax administration sought to combat fly-by-night evasion by attempting to trace transactions down the chain of value added (almost on a transaction by transaction basis) to determine if appropriate VAT had been paid at each point in the process. A regulation, promulgated in 2000, allowed the tax administration to disallow credit claims for otherwise legitimate transactions if fraud was deemed to have occurred at a lower, or subsequent stage, in the production and distribution chain.”<sup>12</sup>.

### **Income tax reporting (SMEs)**

Irrespectively the tax squeezes employers and employees face and the choices they make in response, they are supposed to fill and submit annual tax declarations. The tax declarations are usually filled along with the reports to NSI, since for corporations they must be submitted by the same deadline. Sole proprietors are supposed do the same but by a different deadline.

Even if the declaration and the report are empty (the firm or the entrepreneur declare no activity), the operation is time consuming. It is difficult to calculate the time spent on filling the tax declarations, since it is different from taxpayer to taxpayer. Recently, we measured the time spent on signing the report to NSI.

The firm (sole proprietor) ID number must be filled in 33 times in the NSI form; the tree names of the owner (manager) and the person who filled the report (usually the accountant) 22 times each (irrespectively whether it is one and the same person), and the contact person’s names – 22 time, although it is usually either the owner, the manager or the accountant. Manager and the accountant must sign 50 times. For the economy as a whole it means 124,000 days spent annually on signing NSI forms.

### **Solutions and progress**

1. The tax system needs to be radically reshaped towards more flat and simple, based on equal treatment of different taxpayers. Ideas at hand are numerous, here are some them.

	<b>Corporate Tax</b>	<b>Income Tax</b>	<b>Social Security Taxes (Contributions)</b>
IME	10%	10%	16.7%
Prof. George Petrov <sup>13</sup>	15%	15%	20-25%
Vladimir Karolev	0%	15%	n.a.
BCCI	10%	10%	n.a.
Bulgarian Socialists Party	0%*	10%**	n.a.
2005 Government plan	15%	[10]**12-29 [25]%	42.70%

\*For the reinvested profit; \*\* - discussed as one option.

<sup>12</sup> Robert Conrad, Trip Report Bulgaria. October 2003, p 1 (unpublished). In between other conclusions Dr. Conrad commented with a pinch of pessimism: “The legal basis for this regulation is not clear. Courts in most countries would restrain a tax administration from using such methods. If not the courts, then the taxpayers would make such a public outcry about the regulation, with justification I believe, that the legislature would likely nullify the tax administration’s action.”

<sup>13</sup> Prof. Petrov is a former Board Member of BNB (1997-2002).

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Again, this is not an ideological issue. The consensus is in the direction of flatter and lower taxes. This was the strategic solution implemented by other countries at the eve of EU accession, determined to sustain growth and comparative advantages. There is a need to reform pension and healthcare contributions, but there is no consensus on how to do pursue these reforms.

2. VAT system has made a progress towards shortening the refund period.

VAT bank account system, however, has numerous shortcomings. It creates “potentially only costs with no gain (even in terms of revenue transfers to the government).”<sup>14</sup> Equally important is that there is a prospect that it blocks other reforms like further shorting the tax refund period, deviating the attention of tax authorities from incorrect to correct tax payers, and reducing the incentive to register as VAT taxpayer when and if it becomes voluntary.

3. For sectors like the milk industry, where considerable it is possible to reduce the incentives to underreport by reducing the VAT rate. A 10-percent rate for milk and bread product could reduce the risk by 50%. The industry claims it has packaged reliable and string arguments but it does not believe the reform will happen.

4. The situation requires improvement.

One is to make the VAT registration voluntary. In a combination with the reform of business registration it would both necessary to focus tax administration resources on tracing illegitimate players.

It could also require a greater competition between private pension schemes and the ex-pay-as-you-go system of NOI and reforms that make this system fairer. One example is the reform of the contribution to the pay-as-you-go system of the Russian Federation, which is based on reversed correlation of declared income and contributions and admits that the higher the insured income the lower the contribution. If plans to speed up NOI conversion into individually funded accounts are implemented simultaneously with flatter income taxes, the reform may produce effects similar to those of a flat conventional (income plus social welfare contribution) tax.

With regard to improving the quality of the tax administration and reporting, it is possible to think of:

- a) Limiting the number and prescribing the inspection procedures; such an approach has been introduced recently in Poland through the economic freedom act;
- b) Urging the authorities to adopt procedures that allow to take the tax administration to the court for misallocation of responsibility if fraud occurs in the production/distribution chain;
- c) “Authorizing” the instructions that implement rules, i.e. giving them a rank of a normative act, thus limiting discretionary interpretation but retaining flexibility;
- d) Simplifying tax declarations and NSI reports and providing the opportunity to fill/submit them on line, as it is the case in Estonia.

### *3. Credit-related institutional obstacles*

There are two sets of issues: the legal framework that supports execution of contract between private parties and the environment in which banks and non-bank financial institutions operate.<sup>15</sup>

#### **Contracts between private parties**

One of cross-sector problems private sector encounters is that of the price of credit or rather the impact on that price imposed by contactor who intentionally fail to pay for supplies/services, using holes in the registration system and enforcement rules. The scheme looks as following: a company, it could be even a successful and famous one, orders and receives services/supplies; assets are transferred to “friendship” firms but the original company is declared bankrupt; then, the procedure to collect payment takes long. Inefficiency of creditor rights enforcement procedures; malfunctions of the company register and lack of

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<sup>14</sup> Robert Conrad, Op.cit., p. 18.

<sup>15</sup> We believe this discussion casts some light on the FIAS 2004 finding that perception of costs of financing as an obstacle has risen while objective analysis shows that credit expands, procedures are simpler and the interest rate changed on average (besides residential mortgages) insignificantly.

## **Institute for Market Economics, Bulgaria**

information on debtors<sup>16</sup> impose the costs. The problem is being resolved by bank-guarantee, references and private guarantors and by limiting the circle of customers to only known ones. Two on the interviewed businessmen are using the services of the Bulgarian Bureau on Unreliable Debtors (BUD), a private initiative that helps in such situations. The problem is that BUD comes at hand only *post factum*.

### **Overall shape of bank and non-banking sector policies**

This section is focused on the institutional challenges of Bulgaria's financial industry; it omits issues related to performance of the sector as such and focuses on the private sector development.

1. One respondent defined current policies as "taxing the right side of the balance sheet but paying no or little attention to processes that have impact on the left side". What is needed for sound economic development is that BNB and Government of Bulgaria (GOB) "pay attention to what is going on the left side of the balance sheet".

After fixing the deficiencies of monetary policies in 1997, policy challenges are to be identified in initiatives that provide for using market / reputation mechanisms as alternative to regulation. Examples of "taxing the right side of the balance sheet" are the imposition of deposit guarantee scheme in 1998<sup>17</sup> and plans to introduce minimum reserve requirements (MRR) on long-term, over two-year deposits in 2004.<sup>18</sup>

It is an attempt to resolve through a regulation a problem that emerges from the insufficient quality of underwriting and the limited information exchanged by banks (combined with malfunctioning of other information channels). Deposits are interpreted rather as a current account phenomenon but not a foundation for sound banking.

The law on banks regulates the deposits. It treats them as refundable. It is normal if within the implementation of the rule credit enforcers understand that the time deposits are understood refundable "unless otherwise agreed".

2. Another challenge is to have the reputation as part of the mechanism applied and supported by regulators of the banking industry. Credit institutions are required to submit number of report annually, like reports on capital adequacy, liquidity requirements and so on. These reports are not published and/or summarized in a useful and appropriate manner. Clients are left with somewhat limited opportunity to orient themselves and select between banks, knowing which banks obey the rule and which do not.

3. Information on bank shareholders is missing. The talk about it travels from assessment to assessment report but with little outcome.

4. Banks attempt to compensate for insufficient and ineffective bankruptcy regulations but their limits to their efforts. Many of the problems are in the details. There are postponements due to sick-leaves of debtors, attorneys and/or judges. In the foreclosure process there is negligible issue with mortgaged real estate (especially when the collateral is the residence of the debtor). With other assets the problems amass. Many of the assets are old, from the times before privatization. Multiple appraisals are applicable, all based on "expert assessment". The government has a priority before other creditors, irrespectively the size of the debt. Writs of execution are not always valid, if the procedures applied to different creditors (government and non-government) are different. All these details are inter-related and contribute to the cost of credit and, in a combination with other obstacles to private sector development, reduce the quality of underwriting.

### **Solutions and progress**

There are different, and rather obvious, ways to address the problem on policy level.

1. The modernization of the company registry is one these ways. It should be easily accessible, different company registries, currently based on district courts paper files, should talk to each other and to other government-held data bases and the information should have legal relevance, i.e. be usable for enforcing a contract. The understanding and commitment to amend and reform the company registration is still under

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<sup>16</sup> Two on the interviewed businessmen are using the services of the BUD but admit they are limited.

<sup>17</sup> It required banks' contributions to the central bank managed Deposit Guarantee Fund at the rate of 1.5% of attracted fund with little transparency how the fund is managed and how individual banks comply.

<sup>18</sup> IMF and the GOB in the context of policy mixes to address credit expansion.



question.<sup>19</sup> Business registration reform is a pre-condition and a trigger for other reforms, like, e.g. tax and customs efficiency, credit registries, shortening time to foreclose, etc.

2. Relevant amendments to the Trade Code and other bankruptcy rules and procedures are of equal importance. The reforms and bills has been drafted as early as in the fall of 1998 in relation to then submitted to the Parliament mortgage financing regulations but remain without attention. Several bi-lateral efforts has been launched to improve the Trade Code and Civic Procedures Code, among them a “twinning” program with the government and USAID commercial law reform project but the progress is minimal.

None of the existing programs, however, is addressing the problems related to advantages of the government as a creditor. Equalizing it with private creditors might prove legally difficult, due to existing mindsets. The Decision 2/2000 explicitly mentions that the privilege treatment of debts to government is no violation of the rights of private creditors. What is relatively easier to achieve is the following:

- a) Arrange creditors weight by size;
- b) Provide for procedures that allow that creditor sales the collateral;
- c) Unify the process and the validity of writs of execution irrespectively the nature of the creditor.

Private Bailiffs act has been drafted and submitted to the legislature by a group of prominent legislators. But there is a resistance by government appointed executive judges, and it is not clear whether it will be passed before June elections.<sup>20</sup>

3. A privately owned and managed credit information bureau would compensate for the missing preventive function of BUD. It has been much talked about in the last two-three years. Smaller banks unsuccessfully attempted to obtain control over the provisional information to be exchange by banks and then lobbied for an enlarged and amended role of the BNB credit register. The latter effort was successful but the impact is yet limited due to limited information, slow process and relatively high costs of using this register. At the same time BNB did not openly supported the establishment of any private credit bureau, being afraid of being accused that it facilitates private operations. There are different private initiatives on this front. The most advanced one is, perhaps, that of Experian-Scorex and Serdika Capital Advisors LLC. In November 2003, they signed an agreement for the establishment and operation of Experian-Scorex Bulgaria Credit Bureau (ESBCB). In the first month of this year ESBCB has produced a demo version of the software and have established (in April) two users’ committees, a technical issues and a legal one (on the information sharing, contracts and other relevant matters). Since then they met twice but the process suffered delays, only in February 2005 the Bureau managed to called all the permits.

On one side, participating banks need time to take their decisions. On the other – government institutions show limited understanding. Among them most difficult to communicate with is the Personal Data Protection Commission (PDPC). It took too long to educate the PDPC and then it is silent on registering ESBCB as manager of personal data although the data to be used will be based on clients’ informed consent. ESBCB has started talks with utilities, tax authorities and government agencies that regulate utilities. The understanding is mixed: from full support on behalf of BTC to lack of cooperation from power distribution companies. Perhaps, a publicly expressed support by the GOB and BNB will change these attitudes.

4. Addressing the obstacles related to the “left side of the balance sheet” would require:

- a) Stipulating that “the deposits are refundable unless otherwise agreed”;
- b) Publish reports and/or reviews of reports submitted by banks;
- c) Disclosing shareholders.

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<sup>19</sup> Scott Jacobs of Jacob and Associates has written extensively on the issue; the bank has a copy of his paper “Modernizing business registration in Bulgaria: Options for change”, dated 10 May 2004; as far as it is possible to judge, the comprehensiveness of this reform is far from certain, irrespectively the intense advocacy and the high level of public support.

<sup>20</sup> The draft bill is not that straight-forward legal solution to the stalemate in the foreclosure process as the respective laws of Estonia or Poland, the draft copies the rather ineffective Dutch system; nevertheless, the is no doubt that even in this form it will boost a major improvement in the business environment.

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IMF has raised “C” as an issue as early as in 2001. On “a” there is a correspondence between leaders of the banking sector and IMF mission and there was a discussion on these matters in the press. “B” is discretion of the central bank.

### *4. Obstacles related to the competitiveness of the workforce*

#### **Costs and the limits of informality**

The labor costs are a major part of total business costs. Formal labor employment however increases labor costs, through:

- Additional cost of complying with different labor regulations;
- Additional cost of providing special treatment introduced by different social and health regulations;
- Cost of social security and health contributions;
- Cost of the personal income tax.

As seen in the graph comparing labor rigidity, the situation is far from perfect. However, the potential is there, as it is indicated by the productivity dynamics: Real wages increase hand in hand with productivity and there is virtually no change in ULC between 1998 and 2003. Perhaps through informality, the labor market seems flexible enough keep the ULC fairly stable.<sup>21</sup>

Labor factor creates informality in the development of Bulgaria private sector not only because entrepreneurs seek to reduce labor taxes.

Another implication of labor taxes is that in some segments of the market the need for qualified labor is substantial. These include mostly the production of high-quality, high-tech (using new technologies), design-focused furniture. Such companies depend on their ability to hire people with unique skills, experience and knowledge. These people, we were told in interviews, are not that abundant on the labor market, so companies have to compete to attract them. One way to do so is to offer higher salary; but the employee is interested in net pay. Therefore, those who offer higher salary not burdened with taxes are able to hire the best professionals on the market.

#### **Practicalities**

The CFO of a high tech manufacturing enterprise told us: “high end labor market dry and we are cut off from it; 1,000 lev salary without tax is very different from the same amount but taxed”. This situation was the obstacle No 1 for the manager of the electronics factory: competitiveness is limited by the lack of people; training opportunities and overall declining human resources quality. Most of it is to be explained by size: an exporting industry high-value enterprise, even when largest in the country, has limited resources to alone contribute to universities that train needed engineers and work force. “There is no-one to share the costs with, it is only us in the country”.

In June 2004, two recent focus groups, led by IME and J.E. Austin Associates in Sofia and Plovdiv, with leading business associations and universities revealed that elementary cooperation is either missing or rudimentary. We speak of cost effective mechanisms as: placement programs, alumni involvement, internship, funded research, paid consultancies that benefit both universities and professors, executive training, business participation in curricula committees, joint formal and informal events and other “revolving doors” between education and the economy.

#### **Solutions and progress**

Addressing the issue of workforce competitiveness would require a greater policy effort than simply increasing the mobility of the labor force. It requires a closer look at the incentives of businesses and university to cooperate only on limited grounds. Foreign direct investment is at stake as well. The attraction effort, as outlined in the Investment Promotion Law (i.e. dealing with better government services, faster licensing, etc.), would have only a limited impact. Tax squeezes and demographic provide disincentives to high-end human capital not seek employment in better environments.

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<sup>21</sup> See the graph in the Attachment 2.

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### **5. Obstacles related to public procurement**

According to different sources, the volume of goods and services the government of Bulgaria purchases annually is between Euro 1.5 and 2.1 billion. Information is dispersed and difficult to check without special survey.

“Public procurement is nowhere perfect but in some sectors of the Bulgarian market it is above 50%”. This is the case in pharmaceuticals (65%) and software (50%). In other sectors like transport infrastructure (roads and ports), nuclear energy and power sectors the government is still the only player. With the EU accession subsidies the role of the public procurement will become even more important.

### **Business worries**

The majority of the issues raised by respondent repeat the obstacles related to inequality before the law. Here is the list of critical remarks expressed by the responders:

- Implementation rules of the Public Procurement Law are unclear;
- Auction rules are detailed but not comprehensive; same documents are required for the service of ten thousand and ten million;
- Applications of rules are arbitrary and is not based on clear delegations by the law or the rules; selection criteria are not clear and often change in the post-auction period; alliteratively sometimes the terms of the auction are so concrete that is almost possible to recognize the winner;
- “Postponed payment” [“otlozheno plashtane”] is a prevailing practice that leads to the impossibility to enforce creditors’ rights (ordering institutions, ministries, government funds, agencies, etc. are not registered as commercial entities and courts refuse to consider such cases)
- There is a publicity of the order but not of the results of the auction;
- Duplication of documents by interlinked institutions is common and at every auction in the same institution the same set of documents is required repeatedly;
- Expertise to formulate selection condition in specialized areas is missing.

### **Solutions and progress**

1. May 2004 amendments to the Public Procurement Law implemented four EU directives and is now technically in line with the *acquis*. But usually, the directives regulate the minimal common denominator while member states can still do something better or worse. In Bulgaria, the new Law did not provide for better publicity and clearer procedures. They remain to be drafted and implement by the Public Procurement Agency. The Agency has a low rank, under the minister of economy and will create a Procurement Arbitrage, which also has even lower rank and is exposed to conflict of interest.

2. In this situation the option to compensate for the weaknesses of the Law is that the rules implementing it prove for: a) publicity and accountability, b) less paper work documentation and c) outside expertise in setting the terms of auctions.

### **6. Obstacles and challenges related to EU accession**

#### **Major obstacle**

The EU regulatory zeal coincides with that of Bulgarian authorities. They “tick boxes”, do not implement rules and have been less “monitored” than 2004 members. When implementing the *acquis* the more costly patterns are applied. The EU accession is often the only but abstract justification to regulate. Eventually the process increased costs but omits benefits. Other countries have compensated for those costs by reducing taxes.

#### **Challenges**

Bulgaria finalized negotiation with EU. European commission report 2003<sup>22</sup> is the latest holistic documents that summarizes the economic progress and can be use to summarize the comments of respondents on the EU accession challenges and needs. The table below attempts to put a meaning to

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<sup>22</sup> See: 2003 Regular Report on Bulgaria’s progress towards accession, p. 31-36.

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different estimates of the used indicators for a functioning market economy. The key challenge is not to have “functioning market economy” but well-functioning market economy.

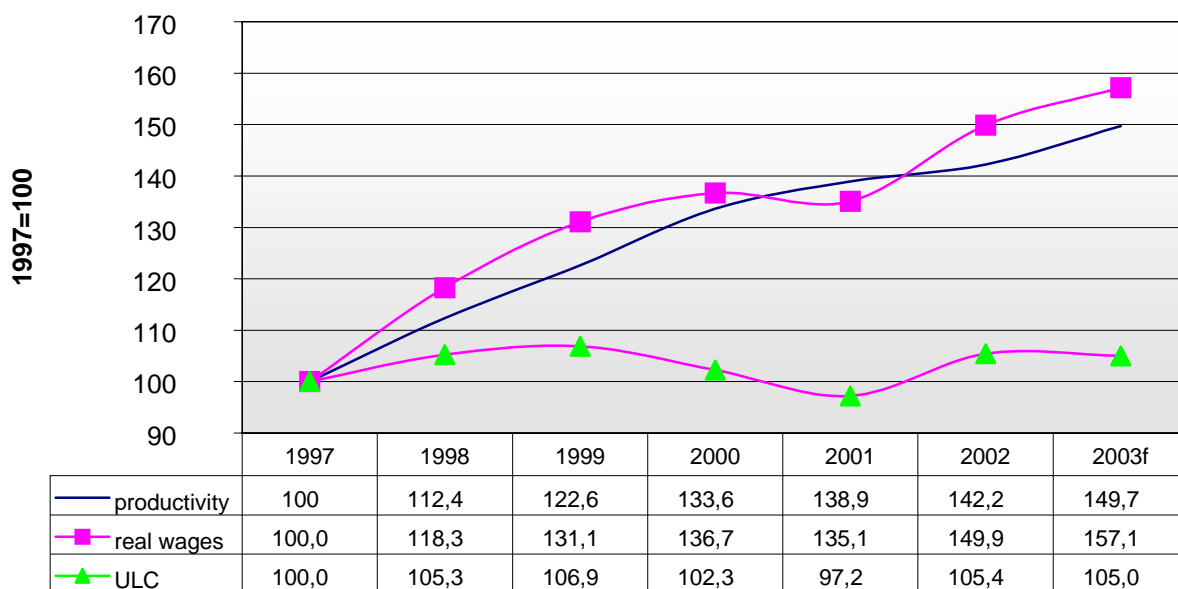
EU Economic Criteria	EU Assessment	Challenges for the development of the private sector
A) Support for economic reforms and EU accession	Continues	EU is viewed as “cash cow”, a “substitute for the Soviet Union”
B) GDP Growth	Sustained at somewhat lower rate	There is room to desire more provided incentive are treated right
C) Current Account	Deteriorates but FDI grows	It is investment driven
D) Unemployment	Decreasing	But shortage of competitive work force is increasing and there is little done to resolve the problem; government employment programs are inefficient
E) Consumer prices and inflation	Decreases significantly	What remains is driven by administered prices
F) Adherence to currency board arrangement	Continues	Under-surface political pressures for government sponsored project (e.g. Belene NPS) may jeopardize stability
G) Fiscal policy	Continues to be tight	The government redistribution remains high (41% of GDP), sustaining higher than needed taxes
H) Macro-economic policy mix	Adequate	No improvement of the management of the budget sector
I) Price liberalization	Progressing but not complete	Liberalization in some sectors (e.g. power) is slow and impedes investment opportunities
J) Private ownership	Progressed further	The government remains major player in key sectors and have advantages before the law
K) Privatization program	Advances more slowly than expected	Some deal have become “a joke”, blocked by interest groups and wrong mindsets
L) Market entry and exit	Not yet working smoothly, but new measures promise improvement; exit is a problem; insolvency remains slow	Policies remain on paper; courts malfunction
M) Enforcement of property rights	Remains difficult in some areas, courts discourage taking cases to courts; costs on property transfers are high	Remains difficult in many areas
N) Bank intermediation	Increasing, interest spreads decrease	Growth impact is positive
O) Non-banking financial sector	Still rudimentary, pension funds assets grow	State pension scheme (NOI) is a prime concern: has advantages vis-a-vie private funds, while their profitability is 11%
P) Supervision	Has been strengthened	Supervisory authority lacks knowledge;

Attachment 1: Respondents

<b>Respondent Position/organization</b>	<b>Background</b>
Banker, BAEF	Mortgage banking and investment fund management
BIA	Customs, trade, market surveys
Epiq Electronic Assembly	Production circuits and parts for automotive industry and medical instruments, part of Epiq Group Belgium
United Milk Company JSC (UMC)	Production and export of milk products, second largest company in the sector
Sanita Trading JSC	Wholesales and retail trading in pharmaceuticals
Cresta Consulting	Advisor
Doverie Investment Holding (DIH) and Mr. Bricolage	Investment in variety of industries (including milk processing, medical supplies, hotels, and “Mr. Brocolage” chain of department stores for home appliances and (semi-finished) furniture; formerly partner in one of the first private consultancies; DIH is the largest privatization fund (voucher privatization)
Bulgarian American Credit Bank	Search and marketing of new financial instruments, special purpose investment vehicles
Pinus Trading	Production of furniture, doors, windows and joints
Balkan Institute for Labor and Social Policies	Labor market research, public administration, job creation and vocational projects;
Sirma Artificial Intelligence	Largest software house with own brands marketed in Bulgaria and abroad; Bulgarian investment in Canada since 1992
Festo Bulgaria LLC	Festo GmbH Austria is a the global leader in pneumatic machines, green-field in Bulgaria
Slavina Hearing Aid LLC (Representative of Phonak Hearing Systems Switzerland),	The company is the oldest authorized distributor of the global leader Phonak; earmarked distribution of government sponsored devices that help people with disabilities
BCCI	Commercial Arbitrage
AIG Bulgaria	Leading insurance company in Bulgaria adhering to best international practice; special attention paid to reinsurance
Center for Liberal Strategies	NGO; Institutional and transaction costs economics

Attachment 2. Productivity Dynamics

**Non-farm Business Sector (1997=100)**



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